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SUBJECT: LESOTHO: WORRYING DOUBLE-DIGIT INFLATION DEVELOPMENTS

11. SUMMARY: Inflation in Lesotho continues to erode economic gains and the purchasing power of salaried employees. The year-on-year increase in the consumer price index reached 10.7% in March 2008, as reported by the nation's Central Bank as well as the Bureau of Statistics, sources which typically underestimate negative fiscal developments. According to these sources, annualized month-to-month inflation reached 19.4% in March. As confirmed by local private bank publications, year-on-year inflation rates have hovered over the 10% mark every month since mid-2007. The rising cost of imports such as food and fuel drive Lesotho's inflation, but factors unique to landlocked Lesotho -- including the drag on productivity of HIV/AIDS, total dependency on ground-transported imports from South Africa, and skyrocketing interest rates -- are compounding the inflationary situation. The pinch is eroding the competitiveness of U.S. Mission local wages in the Mountain Kingdom. END SUMMARY.

Troubling Double-Digit Inflation Numbers

12. Lesotho continues to publish troubling inflation statistics. The nation's Central Bank and the Bureau of Statistics, primary data sources which typically underestimate negative fiscal developments, recently released data detailing a year-on-year increase in the consumer price index from 10.4% in January 2008 to 10.6% in February and 10.7% in March. This data was supported by international financial institutions, including South Africa-based Standard Bank, which issued a "Market Commentary" publication that reported double digit inflation hit Lesotho in 2007 and the inflation rate is still increasing.

13. On May 27, Lesotho's Monetary Policy Committee concluded that increasing food and fuel prices, in addition to factors unique to Lesotho's economy, continue to drive domestic inflation. Annualized inflation in food prices hit 57.2% in April, while annualized fuel prices and taxi fares increased by 44.8% and 34.4% respectively. Lesotho's 2006 inflation rate of 4.8% nearly doubled in 2007 to an annual inflation rate of 8.3% (topping double figures by year's end), leading to a first quarter 2008 rate of 10.3%. During March 2008, Lesotho's annualized month-to-month interest rates reached 19.4%.

South Africa's Problems Magnified

14. As Lesotho is completely surrounded by South Africa and dependent on its imports, South Africa's inflation rate (which reached 10.4% in March) is instantly transferred, and compounded, into Lesotho. Lesotho is so dependent on imports delivered overland that disproportional rises in fuel and food prices compound this "imported inflation." Also, the ravages of HIV/AIDS effect inflation in Lesotho both by negatively impacting productivity and increasing the burden on individuals to provide for infirm and orphaned family members - which decreases savings, and thus capital available in the economy for

investment-fueled growth. These factors have created an economic system in Lesotho which magnifies the economic ills of its larger neighbor, South Africa, including inflation.

Inflation Eroding Local Compensation

15. COMMENT: Hyperinflation has hit Lesotho. Local staff have seen the value of their wages decline precipitously as competitor organizations, including a growing number of international NGOs responding to the HIV/AIDS crisis and entities implementing Lesotho's Millennium Challenge Account Compact, have increased wages by up to 30% to compensate for these conditions. The Government of Lesotho, the country's largest employer, implemented 15-30% wage increases for all civil servants this current fiscal year. As the root causes of this inflation will continue for the foreseeable future, the inflation rate is likely to rise further in the near term.

MURPHY